TAB

MECHANICS OF FEDERAL PRICE CAPS
SHARING AND LOWER FORMULA ADJUSTMENT

Below are several simple examples that outline the two contending methods of calculating the sharing and lower formula adjustment mechanism (LFAM). For the sake of simplicity, we assume that calendar year and tariff year periods are identical. In addition, we also assume in each period realized productivity offset levels that will produce rates of return identical with the first period. The intent of these assumptions is to identify rate of return variations in each year purely as a product of sharing/LFAM exogenous adjustments.

1. Lower Formula Adjustment Mechanism based on earnings including previous LFAM adjustments.

	Gross ROR	LFAM	Adjustments	Net ROR
Base Year(1)	8.0	N/A	0	8.0
Year 2	8.0	10.25	+2.25	10.25
Year 3	10.25	10.25	-2.25	8.0
Year 4	8.0	10.25	+2.25	10.25
Year 5	10.25	10.25	-2.25	8.0
Year 6	8.0	10.25	+2.25	10.25
Year 7	10.25	10.25	-2.25	8.0

In this example, the LEC realizes base year (year 1) earnings of 8.0 percent. In year 2, the LEC is entitled to an exogenous adjustment of +2.25 percent in order to prospectively recoup the shortfall from the base year. If the underlying earnings in year 2 are the same as that in the base year (as assumed above), then the LEC earns 10.25 percent in year 2. In year 3, the LEC having earned 10.25 percent in year 2 is not entitled to an exogenous adjustment. However, if the exogenous adjustment from year 2 is treated as a temporary one, then it must be reversed in year 3. Assuming the underlying earnings in year 3 are the same as that of the base year and year 2, the LEC earns only 8.0 percent in year 3. In year 4, the LEC is once again entitled to an exogenous adjustment and earns 10.25 percent in that year.

The effect of this mechanism is a sawtooth pattern of earnings represented by the Net ROR column above. Specifically, an exogenous adjustment is implemented in year 2 increasing year 2 earnings, and reversed in year 3, reducing year 3 earnings. However, since the adjustment in year 2 is included in the evaluation of earnings for year 2 adjustments, no new adjustment is made in year 3. This depresses year 3 earnings triggering a year 4 adjustment.

Now consider an alternative view where exogenous adjustments are treated as temporary, but are based on prior year earnings not including exogenous adjustments.

2. Lower Formula Adjustment Mechanism based on base earnings excluding previous LFAM adjustments.

	Base ROR	Gross ROR	LFAM	Adjustments	Net ROR
Base Year(1)	8.0	8.0	N/A	0	8.0
Year 2	8.0	8.0	10.25	+2.25	10.25
Year 3	8.0	10.25	10.25	-2.25+2.25	10.25
Year 4	8.0	10.25	10.25	-2.25+2.25	10.25
Year 5	8.0	10.25	10.25	-2.25+2.25	10.25
Year 6	8.0	10.25	10.25	-2.25+2.25	10.25
Year 7	8.0	10.25	10.25	-2.25+2.25	10.25

In this example, the exogenous adjustments are temporary, but each year the underlying base ROR causes an upward exogenous adjustment to nullify the expiration and reversal of the prior year's adjustment. Consequently, the LEC will earn at the lower formula adjustment mark.

The analysis above can be applied to the sharing mechanism.

3. **Sharing mechanism based on earnings including previous sharing adjustments with no interest.**

	Gross ROR	Sharing Trigger	Adjustments	Net ROR
Base Year(1)	17.00	N/A	0	17.00
Year 2	17.00	>16.25 100% 12.25 50%	-2.75	14.25
Year 3	14.25	"	+2.75-1.0	16.00
Year 4	16.00	"	+1.0-1.875	15.125
Year 5	15.125	"	+1.875-1.438	15.562
Year 6	15.562	"	+1.438-1.656	15.344
Year 7	15.344	"	+1.656-1.547	15.453

The method used in this example matches that used in the lower formula adjustment mechanism in 1. above.

In this example, the LEC realizes base year (year 1) earnings of 17.00 percent. In year 2, the LEC is liable for an exogenous adjustment of 2.75 percent in order to prospectively return to the ratepayer 100% of the base year's earnings above 16.25%, and one half of the base year's earnings between 12.25% and 16.25%. If the underlying earnings in year 2 are the same as that in the base year (as assumed above), then the LEC earns 14.25 percent in year 2. In year 3, the LEC having earned 14.25 percent in year 2 is liable for another exogenous sharing adjustment, but this adjustment is smaller than might otherwise be expected since it is based on 14.25 percent earnings and not the underlying 17.00 percent. The exogenous adjustment from year 2 is reversed in year 3, and the LEC earns 16.0 percent. In year 4, the LEC is once again liable for an exogenous sharing adjustment and earns 15.125 percent in that year. This process continues through year 7. Notice that since the underlying earnings for each year are 17.00 percent, this method of computing exogenous sharing adjustments allows the LEC to retain more of its underlying earnings. That is, the ratepayer is entitled to 2.75 percent sharing each year, but never receives it, except in year 2.

Now consider the alternative view where exogenous adjustments are treated as temporary, but are based on prior year earnings *not including* exogenous adjustments. This matches the LFAM method in 2. above.

4. **Sharing mechanism based on earnings excluding previous sharing adjustments with no interest.**

	Base ROR	Gross ROR	Sharing Trigger	Adjustments	Net ROR
Base Year(1)	17.00	17.00	N/A	0	17.00
Year 2	17.00	17.00	>16.25 100% 12.25 50%	-2.75	14.25
Year 3	17.00	14.25	"	+2.75-2.75	14.25
Year 4	17.00	14.25	"	+2.75-2.75	14.25
Year 5	17.00	14.25	"	+2.75-2.75	14.25
Year 6	17.00	14.25	"	+2.75-2.75	14.25
Year 7	17.00	14.25	"	+2.75-2.75	14.25

In this last example, the exogenous adjustments are temporary, and each year analysis of the underlying rate of return of 17.00 percent causes a downward sharing adjustment to nullify the expiration and reversal of the prior year's adjustment. As a consequence, the LEC earns 14.25 percent. The ratepayer and the LEC receive each year their fair share of the earnings (with interest to compensate ratepayers for the time value of money). This appears more in line with the Commission's intent in the Price Cap and subsequent orders.

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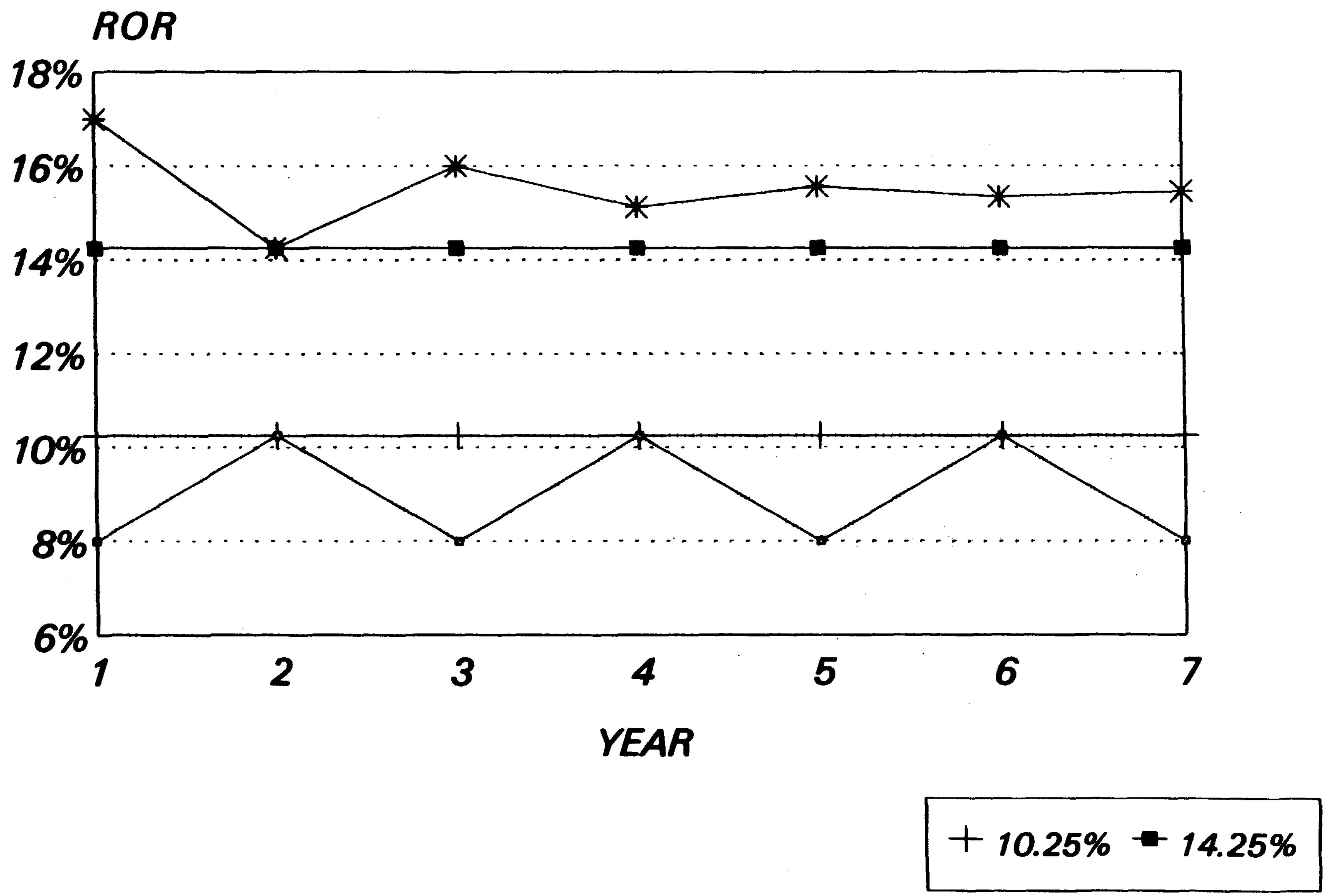

TAB

ISSUE NO. 6: Have the LECs properly reallocated GSF costs in accordance with the GSF Order?

ANSWER: In its GSF Order, the Commission amended its rules to correct the misallocation of general support facilities expenses among the Part 69 cost categories by including Category 1.3 investments (subscriber loop) in the allocator.[1] The NTCs filed tariff revisions to comply with this rule change on June 17, 1993.[2] In the Designation Order, the Commission decided to investigate the GSF tariff filings of all of the LECs because the short time period between the filing of the tariffs and their effective dates did not allow sufficient time for review.[3] The Commission directed the LECs to file direct cases demonstrating that they had properly reallocated GSF costs in accordance with the GSF Order.[4]

In Attachment A to this exhibit, the NTCs have attached the relevant portions of their June 17, 1993 GSF compliance tariff filing. These materials include Workpaper

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1 Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket No. 92-222, FCC 93-238, released May 19, 1993.

2 See NYNEX Telephone Companies, Tariff FCC No. 1, Transmittal No. 203. This filing also included an exogenous cost change for an increase in NECA's Long Term Support payments due to amendments to Section 69.307 of the Commission's rules. The NTCs increased the Common Line basket by $246,815 to reflect the increased payment to NECA. See id. at Appendix C, Workpaper EXG-1, Column C.

3 Designation Order, para. 104.

4 Id. at para. 105.

Delta Y, which was inadvertently omitted from the June 17 filing and which the NTCs submitted in an amended filing on June 23, 1993. Attachment A explains the methodology that the NTCs used to reallocate GSF costs and they provide the data and workpapers underlying the exogenous adjustments for GSF cost shifts. These data show that the NTCs reallocated GSF costs among the price cap baskets in accordance with the Commission's rules.

A. Amended Part 69.307 Rules on General Support Facilities Allocation

On May 19, 1993, the Commission released their Report and Order in CC Docket 92-222 amending the Part 69 rules to correct the misallocation of General Support Facilities investment and related expenses among the Part 69 cost categories for local exchange carriers. The amended rules are to be effective on July 1, 1993. This filing incorporates the reallocation of GSF costs as ordered by the Commission which results in a shift of $124.5 million to the Common Line basket. This shift is comprised of $93.9 million from the Traffic Sensitive basket, $30.1 million is from the Special Access basket, and $.5 million from the Interexchange basket.

Under Section 69.307, GSF investments are currently allocated among the access categories based on investments for Central Office Equipment, Information Origination/Termination Equipment, and Cable and Wire Facilities excluding Category 1.3 investments (subscriber loop investments). Category 1.3 represents approximately 34% of the total investments for the above investment categories. By excluding Category 1.3 from the GSF allocation, the Rules substantially underallocate GSF costs to Common Line and overallocate costs to Special Access and Traffic Sensitive.[2] The Commission's amended Part 69.307 rules correct this misallocation by including the subscriber loop investments in the development of the allocator for GSF costs.

The NTCs are proposing to make exogenous cost reductions to the Traffic Sensitive, Special Access, and Interexchange baskets that would be offset by a corresponding exogenous cost increase to the Common Line basket.

The NYNEX Integrated Separations and Access Charge System (ISAACS) was used to quantify the effects of the changes in the Part 69.307 rules. Both the base and test cases were developed using 12 months of 1992 base year data underlying the 1992 ARMIS Reports. The authorized 11.25% rate of return was used for base and test cases. In both cases, the 1993/1994 composite BAF and Cat3 DEM factors were included in the 1992 data in order to eliminate the effects of the completion of the SPF and Cat3 DEM transitions on the reallocation of GSF costs. In addition, for the Massachusetts and Rhode Island base and test cases, adjustments were made to reflect the December 31, 1992 completion of inside wire amortizations in those states. Without this adjustment, the reallocation of GSF costs would have included the effects of inside wire investments which no longer exist in the July 1993

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[2] See Expanded Interconnection Order, para. 147 and n. 336.

to June 1994 test period. The test case was then developed based on the amended Part 69.307 rules i.e., including Category 1.3 in the GSF allocation. The resulting GSF reallocation was developed by taking the difference between the test and base cases. Workpaper GSF in Section 2.1, Appendix C, details the cost impacts and Workpaper GSF-1 in Section 2.1, Appendix C, details the annualized revenue comparison impacts due to the amended Part 69.307 rules.

The impact of the GSF reallocation on the BFP revenue requirement was determined by taking the difference in the BFP revenue requirement between the test and base cases using the NYNEX Integrated Separations and Access Charge System (ISAACS) data for 1992. The common line BFP revenue requirements for the NTCs are displayed in Appendix B, Section 2.1, Workpaper CL-BFP.

B. Summary of Price Cap Rate Changes

Common Line Services Basket

The Common Line Services basket includes End User Common Line (EUCL) rates, the Special Access Surcharge, and Carrier Common Line (CCL) rates. In this filing, the residence and single line business EUCL rate remains unchanged at $3.50. The multiline business and Centrex rate for Massachusetts increases from $4.44 to $4.97, the multiline business and Centrex rate for New York increases from $5.04 to $5.80, and the multiline business and Centrex rate for Rhode Island increases from $3.77 to $4.16. The multiline business and Centrex rate remains at $6.00 in Maine, New Hampshire and Vermont. The Special Access surcharge remains at $25.00.

The CCL rates are calculated by the formula prescribed in Section 61.46(d) of Part 61 rules which has been used to compute an average CCL rate per minute of use. Appendix B in Section 2.1, Common Line basket, displays the calculation for the NTCs. The formula includes input from Carrier Common Line, EUCL and Special Access Surcharge revenues.

For the NTCs, the CCL rates are increased from existing rates by 37.25%. The proposed premium originating and terminating rates are set at $0.008250. The proposed non-premium originating and terminating rates are set at $0.003713.

Traffic Sensitive Services Basket

This filing proposes rate changes to recurring and nonrecurring Switched Access rate elements in the Traffic Sensitive Services basket. Overall, the proposed base period revenues in the Traffic Sensitive basket for the NTCs have been decreased by 6.19%. Specifically, there is a 7.06% decrease to the Local Switching category, a 5.48% decrease to the Local Transport category, a 4.69% decrease to the Information category and a 4.69% decrease to the 800 Services category. The rate changes for these Traffic Sensitive elements produce an API that is not greater than the PCI for the Traffic Sensitive basket, and the SBI for each service category is within the SBI band limits. The indexes are displayed on the Traffic Sensitive Summary in Appendix B, Section 2.1. A listing of specific rate element changes is displayed in Appendix A, Section 2.1.

Special Access Services Basket

This filing proposes rate changes to recurring and nonrecurring rate elements in the Special Access Services basket. Overall, the proposed base period revenues in the Special Access Services basket for the NTCs have been decreased by 7.57%. For the NTCs, there is a 5.55% decrease to the Metallic, Telegraph Grade, Voice Grade and WATS service category, and a 5.55% decrease to the Program Audio and Video service category. For the Digital Data service (DDS) and High Capacity service category there is an 8.86% decrease. Included in the DDS and High Capacity decrease is the unification of DDS recurring rates and DS1 three and five year discounts.

The rate changes produce an API that is not greater than the PCI for the Special Access Services basket. The SBI for each service category, and the subindexes for DS1 and DS3 services, are within the upper and lower SBI bands.

The indexes and subindexes are displayed on the Special Access Index Summary in Appendix B, Section 2.1. Similarly, a listing of specific rate element changes is displayed in Appendix A, Section 2.1.

Interexchange Services Basket

Rates for Interexchange Services reflect the change in access services as reflected in the delta Y adjustment as well as exogenous changes. Workpaper Delta Y in Section 2.1, Appendix C, shows the calculations of the change in access costs as a result of the change in rates at PCI(t-1) to proposed rates. This calculation displays a reduction in access costs.

The rate changes produce an API that is not greater than the PCI for the Interexchange basket. The indexes are displayed in the Interexchange Index Summary in Appendix B, Section 2,1. A listing of specific rate element changes is displayed in Appendix A, Section 2.1.

The rates for Interexchange Services are reflected in NYT's Interstate Message Telecommunications Service Tariff, F.C.C. No. 40.

C. Computation of Indexes

The indexes for each basket have been calculated to comply with the Commission's Part 61 Rules (Sections 61.45, 61.46, and 61.47). Appendix B in Section 2.1, shows the formula for the PCI calculation in the Price Cap Index Details report for each basket.

The following summary displays the existing and proposed PCI and API for each basket on the appropriate dates for the NTCs.

Existing NTCs Annual Filing PCIs/APIs

	At Last PCI Update		
BASKET	DATE	PCI	API
CL	7/01/93	87.7593	N/A
TS	7/01/93	96.3004	96.3004
SA	7/01/93	100.8352	100.8352
IX	7/01/93	95.5609	95.5609

Proposed NTCs GSF Filing PCIs/APIs

Basket	PCI	API
CL	98.9718	N/A
TS	90.3393	90.3393
SA	93.2042	93.2042
IX	93.1442	93.1442

The changes in the PCI reflect the exogenous cost changes due to amending the Part 69.307 Rules. The changes in the API represent the rate changes, relative to rates as revised in the Annual Filing on June 14, 1993 under Transmittal No. 201 and rates proposed in this filing. The display shows that the proposed rate changes comply with the Commission's rule requiring that the API for each basket not exceed the PCI.

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SECTION 2 APPENDICES

2.1 NYNEX TELEPHONE COMPANIES' WORKPAPERS

SUPPORTING DATA - BASKETS

NYNEX TELEPHONE COMPANIES

APPENDIX B
WORKPAPER C.L.

COMMON LINE SERVICES BASKET

REVENUE SUMMARY ($)

SERVICE CATEGORY	(07/01/93)* EXISTING	(07/01/93)** PROPOSED
CARRIER COMMON LINE	$255,589,902	$350,793,036
SPECIAL ACCESS SURCHARGE	$3,905,975	$3,905,975
EUCL	$716,704,688	$746,222,581
TOTAL REVENUES	$976,200,564	$1,100,921,592

* EXISTING REVENUES = 07/01/93 ANNUAL FILING RATES x 1992 DEMAND
** PROPOSED REVENUES = 07/01/93 GSF RATES x 1992 DEMAND

NYNEX TELEPHONE COMPANIES

APPENDIX B
WORKPAPER C.L.

COMMON LINE SERVICES BASKET
PRICE CAP INDEX DETAILS

CATEGORY	(07/01/93) PROPOSED PCI
GNP-PI	0.0000%
X	0.0000%
DIFFERENCE	0.0000%
Z ADJUSTMENTS ($): *	
GSF	$124,477,236
NECA	$246,815
	$0
	$0
	$0
	$0
	$0
	$0
Z TOTAL	$124,724,051
R BASE REVENUES ($) **	$976,200,564
W FACTOR	112.7765%
G FACTOR	0.0000%
PCI (t-1) ***	87.7593
PRICE CAP INDEX (PCI)	98.9718

PCI(t) = PCI(t-1)*[1+W[(GNP-PI-X-G/2)/(1+G/2)]+Z/R]

* Z ADJUSTMENTS ($): SEE APPENDIX C

** R BASE REVENUES ($) = 07/01/93 ANNUAL FILING RATES x 1992 DEMAND

*** PCI (t-1) EFFECTIVE 07/01/93 - ANNUAL FILING

NYNEX TELEPHONE COMPANIES

APPENDIX B
WORKPAPER C.L.

COMMON LINE SERVICES BASKET

RATE CALCULATIONS
($)

I. CALCULATE AVERAGE CCL RATE			SOURCE
A. CL ALLOWABLE REV (t-1)		$976,200,564	(SEE CALCULATION BELOW)
EU REV (t)	=	$746,222,581	COMMON LINE APPENDIX B PAGE 1
SA Surch REV (t)	=	$3,905,975	COMMON LINE APPENDIX B PAGE 1

B. EU&SAS REV (t)	=	$750,128,556	
TOTAL MOUs (000)			
ORIG PREM DMD		18895457	COMMON LINE APPENDIX A PAGE 1
ORIG NON-PREM DMD		10849	COMMON LINE APPENDIX A PAGE 1
TERM PREM DMD		23581342	COMMON LINE APPENDIX A PAGE 1
TERM NON-PREM DMD		85958	COMMON LINE APPENDIX A PAGE 1

C. TOTAL DEMAND		42573606	
PCI (t)	=	98.9718	COMMON LINE APPENDIX B PAGE 2
PCI (t-1)	=	87.7593	COMMON LINE APPENDIX B PAGE 2
D. PCI % CHANGE		12.7765%	(PCI(t)-PCI(t-1))/PCI(t-1)
E. G FACTOR		0.0000%	N/A FOR THIS FILING
F. AVG CCL RATE (t)	=	0.008240	((A/C)*(1+D))-(B/(C*(1+E/2)))

AVG CCL RATE (t) = (CL REV/MOU)*(1+%CHG PCI)-(SLC REV/(MOU*(1+G/2)))

CL ALLOWABLE REVENUE (t-1) = (CL MOUs * MAXIMUM ALLOWABLE CCL RATE (t-1) + EU REV (t-1))

MAX ALLOWABLE PREMIUM CCL RATE (t-1) =	$0.006011	
MAX ALLOWABLE NON-PREMIUM CCL RATE (t-1) =	$0.002705	
MAX ALLOWABLE PREMIUM CCL REVENUES (t-1) =	$255,328,039	(PREM DMD * MAX ALLOWABLE PREM CCL RATE (t-1))
MAX ALLOWABLE NON-PREMIUM CCL REVENUES (t-1) =	$261,863	(NON-PREM DMD * MAX ALLOWABLE NON-PREM CCL RATE (t-1))
EUCL REVENUES (t-1)	$720,610,663	
TOTAL MAX ALLOWABLE CL REVENUES (t-1) =	$976,200,564	